Christopher Kirkpatrick March 9, 2020
Secretary of the Commission
Commodity Futures Trading Commission (CFTC or Commission)
Three Lafayette Centre
1155 21st Street NW.
Washington, DC 20581

17 CFR Part 23 RIN 3038–AE84

Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants[1] ("Cross-Border Rule" or "Proposed Rule")

Submitted electronically at http://comments.cftc.gov

Dear Mr. Kirkpatrick,

The Institute for Agriculture and Trade Policy (IATP)[2] appreciates this opportunity to comment on the Commission's above captioned proposed Cross-Border Rule. Because it is a common industry practice for Swaps Dealers (SDs) to arrange and market swaps in the United States and trade them through their foreign subsidiaries or affiliates, it is crucial that this normal commercial practice not result in foreign subsidiary swaps activities that evade compliance with Commission requirements. The Cross-Border Rule must enable the Commission to implement and, as appropriate, enforce its requirements while allowing the foreign subsidiaries and affiliates of U.S. ultimate parents to execute and clear swaps transactions in foreign venues. The Commission grants substitute compliance with Commission requirements for foreign regulatory regimes, trade associations and swap entities in non-U.S. jurisdictions to enable cross border swaps activities. However, the Commission must have the means to verify that the foreign affiliate and subsidiary swaps activities do not violate grants of substitute compliance and hence, the cross-border provisions of the Commodity Exchange Act (CEA) and the Dodd Frank Wall Street Reform and Consumer Financial Protection Act (Dodd Frank Act). The following comment aims to assist the Commission in achieving that means to verify that the granting of substituted compliance continues to comply with CEA and Dodd Frank Act authorized requirements.

Summary:

- The Proposed Rule rejects the plain language of Dodd Frank Act amended CEA authority to regulate cross border swaps activities and interprets that authority according a standard derived from Foreign Trade Antitrust Improvement Acts of 1982 case law. Since nothing in the Proposed Rule is stipulated to prevent the unreasonable restraint of trade by the four major SDs, the use of an anti-trust standard to interpret the plain language of Dodd Frank seems disingenuous and can only impede the structuring of a robust Cross-Border Rule.
- The Proposed Rule's weakly documented and perfunctory references to international "regulatory developments" and "market developments" are insufficient grounds for the Commission to withdraw the 2016 Proposed Cross Border Rule.
- The Proposed Rule relies on swaps related concepts of the Securities and Exchange Commission (SEC). The Commission proposes adopting the SEC definition of "U.S. Person" for mostly domestically traded security-based swaps and inappropriately applying that definition for the far larger and more diverse universe of globally traded financial and physical commodity swaps.
- The Proposed Pule in effect replaces the Foreign Consolidated Subsidiary (FCS) category of the 2016 Proposed Rule with the concept of a Significant Risk Subsidiary (SRS) "borrowed" from the SEC (Federal Register (FR) Vol. 85, No. 5, January 8, 2020, Proposed Rules, at p. 965). The FCS is defined by a swaps activity audit trail that can be followed from foreign affiliate swaps trading data to the U.S. ultimate parent by a well-resourced and authorized Chief Compliance Officer (see IATP's comment on the Commission's proposed provisions in swaps management to weaken the authority and autonomy of the CCO[3]). The SRS is defined in such a way as to exclude the swaps activities of most foreign affiliates that, in aggregate, could have the CEA's stipulated "direct and significant" impact on the U.S. ultimate parent, and on the U.S. economy.
- This Proposed Rule relies, in the interest of "international comity," on deference to foreign regulators to regulate the foreign swaps activities of U.S. ultimate parent firms. The proposed regulatory form of the deference principle—"holistic" and "flexible" comparability determinations for substitute compliance with CEA requirements and Dodd Frank Act objectives—abandons the "comprehensiveness" criterion of the 2013 Guidance comparability determination process. "Holistic" comparability definitions may grant substitute compliance for jurisdictions and swaps entities lacking a comprehensive swaps regulatory regime.
- IATP is not able to respond to most Commission's questions concerning definitions, exclusions and exemptions in the proposed Cross Border Rule.

However, the exemptions and exclusions of swaps activities to be counted towards the threshold for registering under the Swaps Dealer and the SEC restrictive "US Person" definition will likely hinder CFTC staff surveillance of cross border swaps trade data and increase the difficulty of market participants to determine whether they comply with the proposed Cross Border Rule.

- Consequent to this summary and the following remarks, IATP urges the Commission to set aside this Proposed Rule and use the 2016 Proposed Rule and the 2013 Guidance on cross border swaps activities as the basis for finalizing new proposed rule.

The Proposed Rule's interpretation of its statutory authority deviates from a plain text reading of the Commission's CEA 2(i) authority

The Proposed Rule begins by citing its statutory authority:

> Given the global nature of the swap market, the Dodd Frank Act amended the CEA by adding section 2(i) to provide that the swap provisions of the CEA enacted by Title VII of the Dodd-Frank Act (''Title VII''), including any rule prescribed or regulation promulgated under the CEA, shall not apply to activities outside the United States (''U.S.'') unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States, or they contravene Commission rules or regulations as are necessary or appropriate to prevent evasion of the swap provisions of the CEA enacted under Title VII. (FR 954)

Then, following a recitation of prior Commission action to implement CEA 2(i), the Commission explains its rationale for withdrawing the 2016 proposed Cross Border Rule and for deviating from the plain text of CEA 2(i) used as the bedrock for the 2013 Guidance on cross border swaps activities: "However, in light of the passage of time since the publication of the Guidance, the Commission is restating its interpretation of section 2(i) of the CEA with the Proposed Rule." (FR 955). The "passage of time" justification for re-interpreting CEA 2(i) refers, albeit euphemistically, to the rationales for withdrawing the 2016 Proposed Rule, rationales that we criticize below, although the Commission requests no comment on these rationales nor on its reinterpretation of CEA 2(i). (FR 955)

The Proposed Rule reinterprets the statutory authority of the CEA 2(i) in terms of a U.S. legal analogue to the Commission's understanding of international comity, rather than basing the Proposed Rule in the plain language of CEA 2(i). This reinterpretation subjects the CEA 2(i) to the standard of the Foreign Trade Antitrust Improvement Acts (FTAIA) of 1982, "which provides the standards for the cross-border application of the Sherman Antitrust Act" (FR 955) plus court rulings on anticompetitive business practices. The

choice of the FTAIA standard for interpreting the meaning of "direct" in CEA 2(i) is ironic to say the least, since just four U.S. commercial banks were counterparties to 87 percent of all swaps in the third quarter of 2019.[4] There is no indication in this or other proposed swap rules that the Commission is concerned that these four SDs might be subject to the market concentration test indicative of unreasonable restraint on trade under the Sherman Act or the FTAIA.[5] Indeed, the just released "Economic Report of the President" dismisses academic research showing harm to consumers and competing firms by oligarchic industry structures.[6]

The footnoted journey through FTAIA case law on the meaning of "direct" in CEA 2(i) leads to this conclusion:

> the Commission interprets the term ''direct'' in section 2(i) to require a reasonably proximate causal nexus, and not to require foreseeability, substantiality, or immediacy. Further, the Commission does not read section 2(i) to require a transaction by-transaction determination that a specific swap outside the United States has a direct and significant connection with activities in, or effect on, commerce of the United States to apply the swap provisions of the CEA to such transaction. (FR 957)

It is disingenuous to imply that the Commission must focus on a specific cross border swap transaction to document "a direct and significant connection." Commission surveillance of aggregated data from transactions reported to foreign Swaps Data Repositories (SDRs) is the most likely and efficient means to begin determining how cross-border foreign affiliate swaps of U.S. ultimate parents might affect U.S. commerce. Whistle blower allegations and/or investigative journalism might instigate intensified Commission swaps data surveillance.

The Proposed Rule's tortuous interpretation of the plain meaning of "direct" in CEA 2(i) is rational only in the context of the flawed rationales (analyzed below) for withdrawing the 2016 Proposed Rule, one of whose principle features is the definition of a Foreign Consolidated Subsidiary (FCS) category. If there is an "international comity" argument to justify deviating from the plain meaning of "direct" and rely on FTAIA case law to interpret "direct," that argument is not given in the Proposed Rule.

Rather than interpret "direct" in terms of FTAIA case law, there is a more reasonable and practicable way for the Commission to measure the "direct and significant connection" of foreign affiliate swaps of U.S. ultimate parents to the U.S. economy. In December 2016, IATP wrote to the Commission,

> IATP agrees with the Commission's proposed definition of "Foreign Consolidated Subsidiary" (FCS) and with the proposed test, according to U.S. Generally

> Accepted Accounting Principles, to determine the economic impact of swaps transacted by a non-U.S. person but that are reported in the consolidated financial reporting of the FCS's U.S. parent. Given the myriad affiliates of U.S. SDs and MSPs, the FCS definition provides the bright-line test that the CFTC can use to determine which trading activities of which affiliates pose greater risks to the U.S. economy and therefore merit more intense surveillance and possible enforcement activities.[7]

Although the Commission asks no questions about the FCS definition, IATP reiterates its agreement with the 2016 FCS definition and with the use of an FCS demarcated swaps data audit trail both for surveillance and enforcement purposes. Furthermore, such swaps data auditing can be used to verify that the continuation of grants of substitute compliance for foreign regulatory jurisdictions, trade associations or SDs are still valid and/or require modification to be continued.

In sum, the Commission's reliance on cross-border anti-trust trade law to interpret its statutory authority under CEA 2(i) is an inconsistent and unreliable foundation for a rule that proposes no measures to prevent or discipline SDs' unreasonable restraint of trade. IATP advises the Commission to abandon this "restatement" of its CEA 2(i) authority and rely on a plain reading of CEA 2(i).

The "Regulatory Developments" justification for withdrawing the 2016 proposed Cross Border Rule

The Commission has decided to withdraw its 2016 proposed Cross-Border Rule and replace it with the present Proposed Rule. The major justification for withdrawal and replacement is "due to market and regulatory developments in the swap markets and in the interest of international comity, as discussed in this release." (FR 954) The sole source of evidence cited regarding "regulatory developments" is the Financial Stability Board (FSB)'s latest progress report on implementation of regulatory reforms in Over the Counter derivatives (swaps) trading.[8] No doubt that the FSB members' reporting on swaps related legislative and regulatory developments to the FSB Secretariat represents progress in beginning to regulate swaps, compared to the 2010 benchmark, when there was no such regulation. Indeed, in our letter commenting on the proposed 2016 Cross Border Rule[9], we cited not only FSB Chairman Mark Carney's comment on FSB member progress, but also CFTC Chairman Tim Massad's comment that centralized clearing of swaps and other swaps regulatory reforms enabled the financial system to absorb, rather than amplify, the shock of the Brexit decision.[10]

Nevertheless, as the FSB Secretary General noted in 2019, much remains to be implemented of the FSB members' reported reforms:

> Ensuring resilience in all these areas [including OTC derivatives reporting] is important as vulnerabilities persist and, in some cases, have increased further.

> Elevated asset values, high private and public debt, and deteriorating credit quality all pose risks. Since 2010, the share of corporate issuers with the lowest investment grade rating has risen from around 14% to 45% in Europe and from 29% to 36% in the United States. There are questions about the extent of financial institutions' exposures to riskier credits, including leveraged loans, but also through collateralised loan obligations (CLOs). While CLO structures appear more robust now than pre-crisis, leveraged loan credit quality has deteriorated over the past few years and it remains unclear whether CLO prices are aligned with risk. [11]

The Secretary General was careful to note, of course, that his remarks did not represent the views of FSB members. However, because CLOs are among the swaps instruments arranged in one jurisdiction and traded from another, e.g. the Cayman Islands,[12] the vulnerabilities briefly outlined by the Secretary General require robust cross border regulatory tools, such as comprehensive and standardized near real time reporting of OTC derivatives trade data. Only a robust reporting regime can enable adequately resourced regulators to monitor the performance of and prevent defaults among CLOs held by U.S. banks, hedge funds and insurance companies.[13] The electronic auctioning of CLOs in the secondary market will both grow the CLO market and increase the challenge of CLO regulatory oversight.[14]

Furthermore, Systematically Important Financial Institutions (SIFIs) and counterparties to those SIFIs continue to exploit regulatory loopholes and unregulated interstices of the financial system to harm not just market participants, but the stability and integrity of the financial system.[15] Such are the scale of the pecuniary rewards of financial misconduct, relative to the relatively small scale of fines paid by shareholders—$372 billion for the 50 largest US and European financial firms from 2009 to 2018[16]-- that prevention of misconduct is to be infinitely preferred over enforcement actions that are too late and too small to dissuade recidivism, recover full damages and restore market integrity.

The mere adoption of legislation or regulation to govern Swaps Execution Facilities (SEFs), SDs and MSPs is far from ensuring that foreign regulators have the capacity to implement and enforce the swaps rules in their jurisdictions. The further one analyzes the FSB report, the more it appears that the FSB is diplomatically generous when it characterizes the progress of implementation as "limited."[17] Several fundamental reforms are just beginning and are far from realized "regulatory developments." Among the initiatives that are just beginning to address implementation challenges are facilitating access to trade data repositories, adopting standards to aggregate and make comparable swaps data across EU member states and other jurisdictions, and improving swaps data quality.[18] In a better world, physical swaps data elements, including that of agricultural swaps, would be standardized so they can be aggregated and compared for regulatory purposes.

IATP is not looking at a cross-border regulatory glass that is half empty but that the Commission regards as full enough to jettison the 2016 Proposed Rule. Rather, we are reminding the Commission that "regulatory developments" to govern cross border swaps entities, transactions and venues are far from complete operationally. The FSB report states, "OTC derivatives data elements need maintenance and governance in order to ensure that they remain up to date, evolve to reflect market practices and continue to support regulatory needs."[19] Harmonization of the data elements among jurisdictions so that regulators are able to monitor swaps trade data in aggregated and comparable terms is not a half-full glass but the computerized plumbing of the financial system. If the plumbing infrastructure and personnel are perennially underfunded, as has been the case at the CFTC,[20] to say nothing of other jurisdictions, the "regulatory developments" become less operational or even nonoperational.

IATP believes that the Commission relies far too greatly on the FSB report of progress, however limited, as the basis for deference to foreign regulatory regimes in the name of "comity." As Commissioner Rostin Behnam's dissent notes, the Proposal references "comity" without providing supporting rationales for deferring to our fellow domestic regulators and foreign counterparts or for providing per se exemptions." (FR 1011) Indeed, the proposed deference to the SEC and its jurisdiction over the relatively small and mostly domestic market of security based swaps as the basis for the definition of "US Person," applied to the far greater global market of commodity swaps, is perhaps the least justified rationale for deference in the proposed rule.

The market developments" justification for setting aside the 2016 Proposed Rule

In their dissents to the release of the proposed rule, Commissioners Dan Berkovitz and Rostin Behnam (FR 1009-1016) summarized some of the market events before and after the enactment of the Dodd Frank Act that lead Congress to mandate the Commission to regulate cross-border swaps activities. Because no cross-border swaps regulation was in place in 2008, the foreign jurisdiction swaps activities of Lehman Brothers, AIG and other U.S. and foreign SDs, rescued by more than $29 trillion in Federal Reserve emergency loans,[21] prompted Congress and then the Commission to act to prevent a re-occurrence of adverse impacts on the U.S. economy originating in swaps activities of the foreign affiliates of U.S. ultimate parents in foreign venues.

In contrast to the abundant documentation to justify the 2013 Guidance and 2016 Proposed Rule, the "market developments" justification for the 2019 Proposed Rule references cited discussions with market participants (FR 358 et passim) as reason to set aside the Commission's 2016 Proposed Rule. The Commission suggests that the present Proposed Rule will be consistent with the Dodd Frank Act amendments to the CEA while "mitigating market distortions and inefficiencies and avoiding fragmentation." (FR 958) Presumably, these discussions with market participant concerned their complaints about alleged distortions, inefficiencies and fragmentation resulting from compliance

with the 2013 Guidance. But because the discussions between the Commission and market participants are *ex parte* communications, there is no way to verify that presumption nor rebut it. IATP supports the recommendations of the October 21, 2019 letter from Better Markets to the Commission to limit the use of *ex parte* communications in rulemaking and other Commission activities.[22]

Academic researchers have found that the introduction of Swaps Execution Facilities (SEFs) and post-trade transparency measures have improved liquidity and reduced execution costs in U.S. markets. Central clearing of swaps has reduced counterparty risk and systemic risk and improved swap market liquidity.[23] Cross border swaps activity will be more difficult to research because of the need to access data from several jurisdictions for swaps originating with U.S. parents but transacted in foreign venues. As foreign Swaps Data Repositories become more comprehensive in collecting, standardizing and aggregating swaps data and agreements between regulators are made to allow both regulator and research access to those data, it will become easier to research cross border swaps activities.

To the extent that swaps markets are fragmented by arranging swaps in one jurisdiction and transacting and clearing them through a foreign affiliate in another jurisdiction, compliance with the 2013 Guidance is not the cause of that fragmentation, as alleged by market participants. Instead liquidity fragmentation may be the result of a SD or MSP strategy to avoid U.S. swaps requirements. As noted above, the Foreign Consolidated Subsidiary in the 2016 Proposed Rule provided the Commission with a framework, delineated by U.S. GAAP, for surveillance of foreign affiliate swaps trade data of U.S. parents to determine the effect of cross border swaps on the U.S. parent and on U.S. commerce. With the withdrawal of the 2016 Proposed Rule, due to the Commission's representation of "regulatory and market developments," there is no FSC definition or framework.

The proposed Significant Risk Subsidiary: an inapplicable cross border swaps category

Instead of the FCS category, the Commission proposes a Significant Risk Subsidiary (SRS) category as a framework for aggregating cross border swaps data that might have a "direct and significant" effect on the U.S. parent and U.S. commerce. The Commission explains, "Through consolidation, non-U.S. subsidiaries of U.S. persons may permit U.S. persons to accrue risk through the swap activities of their non-U.S. subsidiaries that, in aggregate, may have a significant effect on the U.S. financial system." (FR 964) The SRS, like the FCS would be operationalized according to the U.S. GAAP.

> However, the Commission preliminarily believes the principles of international comity counsel against applying its swap regulations to all non-U.S. subsidiaries of U.S. parent entities. Rather, the Commission believes that it is consistent with such principles to apply a risk-based approach to determining which of such entities should be required to comply with the Commission's swap requirement. (FR 964)

By applying the "risk-based approach" and deference to foreign regulatory regimes in the name of international comity (FR 966) , the Commission's proposed exclusion from swap regulations and cost to market participant analysis determines that "Of the 60 non-U.S. SDs that were provisionally registered with the Commission as of December 2019, the Commission believes that few, if any, would be classified as SRSs pursuant to the Proposed Rule." (FR 992) The SRS category, derived both from Federal Reserve "safety and soundness" regulations under the Bank Holding Company Act and from the SEC, leaves the Commission "few if any" non-U.S. subsidiaries to regulate under the authority of the CEA as amended by the Dodd Frank Act.

Commissioner Berkovitz, in his dissent to releasing the Proposed Rule, asked "What is the purpose of creating a complicated category [the SRS] that does not include a single entity?" (FR 1013) He does not directly answer his question. We understand that with the SRS multi-prong definition and exclusions, the Commission intends to comply with (CEA) section 2(i) but quantify "significant" is such a way that the SRS category will not apply to the foreign affiliate swaps activities that are arranged by and guaranteed, de jure or de facto, by U.S. ultimate parents. The Commission's elaborate arguments for exclusions from applying swaps regulations to the non-US subsidiaries and affiliates of U.S. ultimate parents excludes nearly all non-U.S. swaps entities from SRS swaps requirements, relieving market participants of regulatory costs and burdens. The extreme and radical reduction in the application of Commission swaps regulations means that the Commission, market participants and the public must rely overwhelmingly on the efficacy of foreign regulatory regimes and swaps entities granted substitute compliance by the Commission, to protect U.S. commerce from negative impacts of foreign affiliate swaps activities.

Harmonization: Regulatory Deference and International Comity

The Proposed Rule summarizes Dodd Frank Act's Section 732 (a): International Harmonization in a footnote: "the Dodd Frank Act requires the CFTC to consult and coordinate with other regulators on the establishment of consistent international standards with respect to the regulation (including fees) of swaps and swap entities." (FR 962, footnote 111) This summary, however, does not include the remainder of the Section 732 paragraph: the CFTC, the SEC and the prudential regulators "may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors, swap counterparties, and security-based swap counterparties."[24] The Congress requires the Commission not just to "consult and coordinate with other regulators" such as the FSB, to establish international standards for regulating swaps. Congress has given the Commission the discretion to negotiate information sharing agreements with foreign regulators to enable it to access the foreign affiliate swaps data of a US ultimate parent, if that parent does not respond fully and in timely fashion to the Commission's request for such data. In this Proposed Rule, there is no mention of how international standards are to be implemented by the sharing of swaps trading data.

The main principle of international harmonization underlying the Proposed Rule is deference to foreign regulators whose rules produce regulatory outcomes comparable to those of the Commission. The principle is perhaps most succinctly expressed by former CFTC Chairman Christopher Giancarlo:

> The CFTC should act with deference to non-U.S. regulators in jurisdictions that have adopted comparable G20 swaps reforms, seeking stricter comparability for substituted compliance for requirements intended to address systemic risk and more flexible comparability for substituted compliance for requirements intended to address market and trading practices.[25]

In the summary of Federal Reserve Bank of New York, the G20 swaps reforms that address systemic risk are limited to these:

> In 2009, the G20 Leaders agreed to reforms in the OTC derivatives market to achieve central clearing and, where appropriate, exchange or electronic trading of standardized OTC derivatives; reporting of all transactions to trade repositories; and higher capital as well as margin requirements for non-centrally cleared transactions.[26]

Swap reforms to mitigate systemic risk are progressing, according to the report of FSB members. However, "requirements intended to address market and trading practices" are more numerous and various, and, in our view, more difficult to implement.

Applying the principle of deference to foreign regulatory regimes in grants of substitute compliance, comparability determinations and exceptions to compliance with Commission regulations

The justification for changing the reclassification of Commission market and trading practice requirements from the Guidance's Entity Level Requirements (ELR) and Transaction Level Requirements (TLR) to the A, B and C Groupings of the Proposed Rule is stated clearly:

> To avoid confusion that may arise from using the ELR/TLR classification in the Proposed Rule, given that the Proposed Rule does not address the same set of Commission regulations as the Guidance, the Commission is proposing to classify certain of its regulations as group A, group B, and group C requirements for purposes of determining the availability of certain exceptions from, and/or substituted compliance for, such regulations. (FR 980)

What is not clear is which set of regulations are covered by the Proposed Rule that are not covered by the Guidance. Without a comparative (preferably tabulated) summary of the different set of regulations covered by the Guidance and the Proposed Rule, there is no grounds to judge readily why the Commission proposes to abandon the readily understood ELR and TLR classifications of requirements to compare for granting substitute compliance to foreign regulatory regimes. This lack of clarity is compounded by the proposed exceptions from Commission regulations for Group B and C requirements and substitute compliance for Group A and B requirements. Applying the proposed comparability determination criteria that justify grants of substitute

compliance to Group A and B requirements and exceptions from cross border regulation to Group B and C is much more difficult than Table C (FR 1000) and Table D (FR 1001) would indicate because of the "flexibility" of the comparability criteria.

Before trying to illustrate the difficulty of applying the proposed comparability determination criteria to group A and B classified requirements, we comment briefly on the proposed exceptions to cross-border regulation. The biggest exception, in terms of notional swaps value and the number of Group B and C requirements that would be exempted from compliance, is the Group B and C exception from "certain Commission regulations for "certain anonymous, exchange traded and cleared foreign swaps" of U.S. ultimate parents. (FR 982) Despite the imprecision of "certain" throughout the proposed exception, this exception would comport generally with G20 reform objectives to centrally clear swaps and trade them anonymously (preferably post-trade as well as pre-trade) on regulated exchanges. What IATP objects to in the proposed exception is to grant the exception for foreign SEFs and clearing organizations that have not qualified for registration with the Commission, but have been granted exemptions from registration, presumably in the interest of international comity.

The Commission contends:

> The Commission expects that the requirements that the swaps be exchange-traded and cleared will generally limit swaps that benefit from the exception to standardized and commonly traded, foreign-based swaps, for which the Commission believes application of the remaining group C requirements is not necessary. (FR 983)

IATP hopes that our objection is without foundation and that the Commission's expectation is accurate. If the exchange trade exception results in disapplication of Commission requirements to customized foreign affiliate swaps traded and cleared on exempted entities, the risks to U.S. ultimate parents could be most unexpected.

IATP does not understand the other three proposed exceptions from compliance with Group B and C requirements. The exceptions are predicated in part on assumption of strong foreign regulatory interest (and capacity?) in the exempted entities and transactions that IATP is no position to judge. So we will will not comment on these proposed exceptions to Commission regulations.

Comparability determinations for the granting of substitute compliance to foreign regulatory jurisdictions and swap entities

The Proposed Rule provides a Group A and B classification of which non-U.S. swap entities and activities are eligible for "flexible comparability" in substitute compliance. "Comparable" already provides for flexibility relative to the standard of being "consistent" with Commission regulatory requirements: "flexible comparability" provides yet more leeway. The 2013 Guidance allowed for flexibility for substitute

compliance, provided that the swaps regulations of a foreign jurisdiction were as comprehensive as those of the Commission:

> In evaluating whether a particular foreign regulatory requirement(s) is **comparable and comprehensive to the applicable requirement(s)** [our emphasis] under the CEA and Commission regulations, the Commission would take into consideration all relevant factors, including but not limited to, the scope and objectives of the relevant regulatory requirement(s), and the **comprehensiveness** of those requirement(s), the **comprehensiveness** of the foreign regulator's supervisory compliance program, as well as the authority to support and enforce its oversight of the non-U.S. swap dealer or non-U.S. MSP applicant. In this context, comparable does not necessarily mean identical. Rather, the Commission would evaluate whether the home jurisdiction's regulatory requirement is comparable to the regulatory requirement(s) supported and enforced by the Commission.[27] (Federal Register, Vol. 77, No. 134, July 12, 2012 / Proposed Rules 41233)

IATP could not find a rationale in the Proposed Rule for abandoning the comprehensiveness requirement for comparability determinations in the 2013 Guidance. The closest approximation to an explanation for the abandonment of the comprehensiveness criterion we find not in the text, but in a footnote:

> Under the Proposed Rule, the Commission would consider all relevant elements of a foreign jurisdiction's regulatory regime; however, the fact that a foreign regulatory regime may not address one of more of such elements would not preclude a finding of comparability by the Commission. Also, in making a comparability determination, the Commission would have the flexibility to weigh more heavily elements it deems to be more critical than others and less heavily those that it deems to be less critical. (FR 985, footnote 342)

Our interpretation of this footnote is that an element in a foreign regulatory regime, e.g. a rule on reporting or record keeping that lacked data elements of swaps transaction reporting and recordkeeping required by the Commission, might be regarded as less critical and therefore no impediment to a Commission finding of comparability. At what point does a finding according to flexible criteria not become comprehensive and at what point is a non-comprehensive comparability determination become the basis for granting "holistic" substitute compliance? Based on the Proposed Rule, IATP cannot answer this question. Since the Commission claims that the Proposed Rule will enable more "holistic" and yet flexible comparability determinations, the rule should be revised to include a non-exhaustive list of what swaps regulatory elements the Commission considers to be "more critical" and "less critical."

IATP does not pretend to understand all the rationales for these A, B, C group classifications nor can we respond to Commission questions about the classifications. However, it does appear that the classifications have less to do with protecting the U.S. economy from the risks of foreign affiliate swaps trading than ensuring that substitute

compliance will facilitate a global swaps market while minimizing regulatory costs to market participants:

> The Commission also understands that by not offering substituted compliance equally to all swap entities, the Proposed Rule, if adopted, could lead to certain competitive disparities between swap entities. For example, to the extent that a non-U.S. swap entity can rely on substituted compliance that is not available to a U.S. swap entity, it may enjoy certain cost advantages (e.g., avoiding the costs of potentially duplicative or inconsistent regulation). The non-U.S. swap entity may then be able to pass on these cost savings to their counterparties in the form of better pricing or some other benefit. U.S. swap entities, on the other hand, could, depending on the extent to which foreign swap requirements apply, be subject to both U.S. and foreign requirements, and therefore be at a competitive disadvantage. (FR 996)

Comparability determinations for substitute compliance are offered only to foreign regulators for specific swaps requirements.[28] Accordingly, we understand the Proposed Rule to mean not that the Commission is directly negotiating substitute compliance with foreign swaps entities, but that applying comparability determinations to Group A and B requirements will result in grants of substitute compliance that will not apply equally to all the non-U.S. swaps entities in those jurisdictions and will disadvantage some of those entities economically. IATP does not believe that the Commission should make the costs of complying with or economic benefits from substitute compliance a decision criterion for comparability determinations. Participation of non-U.S. swaps entities in U.S. markets is a privilege with consequent costs and benefits, not an inalienable right.

The Proposed Rule aims to make comparability determinations more "holistic" by expanding the universe ad infinitum *of what is compared to Commission requirements:*

In the following explanation, it appears that Commission considers that the central bank supervision by guidelines, not regulations, of financial holding companies allows the Commission to further relax comparability determination requirements:

> Further, given that some foreign jurisdictions may implement prudential supervisory guidelines in the regulation of swaps, the Proposed Rule would allow the Commission to base comparability on a foreign jurisdiction's regulatory standards, rather than regulatory requirements. Although, when assessed against the relevant Commission requirements, the Commission may find comparability with respect to some, but not all, of a foreign jurisdiction's regulatory standards, it may also make a holistic finding of comparability that considers the broader context of a foreign jurisdiction's related regulatory standards. (FR 987)

It is not clear from this explanation how a standard differs from a regulatory requirement and whether compliance with the standard, e.g. a trade association's business conduct standard, is voluntary. Is the framework of the proposed comparability determination to compare a voluntary standard with a mandatory requirement? If a foreign jurisdiction lacks a standard that compares to a Commission requirement, the

Commission should issue a more limited comparability determination until such time as when the foreign jurisdiction has published a standard that would result in a regulatory outcome comparable to that of a Commission requirement. IATP does not believe that the Cross-Border Rule can be effectively implemented, if the contextual basis for a "holistic finding" is so remote from the Commission's requirement as "the broader context of a foreign jurisdiction's related regulatory standards." If the Commission proposes to introduce so much flexibility into what is compared to Commission requirements, it should include a non-exhaustive list of such "holistic" comparability determinations as an appendix to the Proposed Rule. The list would help commenters judge what the Commission intends in its proposals to compare standards to requirements.

Comparability determinations enable the Commission to better understand non-U.S. regulatory regimes, and how they are implemented and enforced. But regulatory deference to jurisdictions whose rules the Commission finds to produce regulatory outcomes comparable to those of the Commission must not be vague, unconditional nor of indefinite duration. During market events, credit events or in the event of swaps trading data anomalies, the Commission must retain the means to verify that the foreign affiliate swaps trading of U.S. parents does not result in losses that the U.S. parent must guarantee, either as a matter of law or a matter of market practice. The FSC definition provided an auditable and efficient means to respond to such events, but the Proposed Rule imprudently removes the FSC and its supporting provisions.

Harmonization: Regulatory Deference and Domestic Comity

As noted above, the Proposed rule borrowed from the Federal Reserve System and the SEC to create the Significant Risk Subsidiary category. The Commission has further deferred to SEC in borrowing its more reductive definition of "U.S. Person," rather than retaining the more comprehensive definition in the 2013 Guidance and the 2016 Proposed Rule.

The Cross-Border Rule should not derive the "U.S. Person" definition from the SEC definition that applies to the relatively small universe of security-based swaps. For example, in the third quarter of 2019, equity OTC derivatives contracts amounted to just 0-3.4% of all OTC derivatives contracts held by the top ten commercial banks.[29] It is not just physical commodity swaps that are traded globally, but thanks to automated trading, foreign exchange and interest rate swaps migrate from their markets of origin to trading venues around the world.[30]

The Commission should adopt the U.S. Person and other definitions of the 2016 Proposed Rule for the much larger universe of physical and financial commodity swaps the Commission is authorized to regulate. There is no regulatory virtue in rejecting the

definition of "U.S. Person" in the 2016 Proposed Rule for the Commission to be consistent with the more limited SEC definition of "U.S. Person."

It appears that the chief reason for regulating the financial and physical commodity swaps based on a definition of "U.S. Person" the SEC developed for security-based swaps is for the convenience of SDs and MSPs:

> the Commission believes that having a definition that is harmonized with the SEC allows for more efficient application of the definitions by market participants, including entities that may engage in dealing activity with respect to both swaps and security-based swaps. (FR 962)

SDs and MSPs have the personnel and computer infrastructure resources to comply effectively with reporting and recording keeping of swaps and security-based swaps. Any reduced efficiency is more than compensated for by having the "US Person" definition apply not only to enumerated entities but to a non-exhaustive listing that anticipates the creation of new legal entities engaged in swaps activities.

Conclusion

This letter is far from a comprehensive comment on or response to the text and questions in the Proposed Rule. Nevertheless, IATP hopes that issues raised in this letter will help persuade the Commission to re-propose the Cross-Border Rule based the 2016 Proposed Rule and 2013 Guidance. Absent such a re-proposal, at a minimum the Commission should

- delete the all but inapplicable Significant Risk Subsidiary;
- restore the Foreign Consolidated Subsidiary definition and its allied provisions;
- restore the "U.S. Person" definition from the 2013 Guidance and 2016 Proposed Rule
- revise the Commission's interpretation of "direct and significant connection" in CEA 2(i) to build on the plain language of the statute;
- revise the Commission's representation of international "regulatory developments" to incorporate a realistic assessment of the implementation of swaps reforms reported to the FSB and other relevant international bodies, and the capacity of foreign regulators to implement the reported swaps reforms;
- revise the Commission's representation of international "market developments" to include research on swap markets, instruments and risks, and on incidents of SD and MSP misconduct and regulatory evasion, and not rely simply on the *ex parte* communications of market participants for the Commission's understanding of recent "market developments."

IATP thanks the Commission for its consideration of this letter. Please contact us at 612-870-0453 ext. 3413, if you have questions about these comments.

Respectfully,

Steve Suppan, Senior Policy Analyst

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[1] https://www.cftc.gov/sites/default/files/2020/01/2019-28075a.pdf

[2] IATP is a U.S. nonprofit, 501(c)(3) nongovernmental organization, headquartered in Minneapolis, Minn., with offices in Washington, D.C. and Berlin, Germany. IATP participated in the Commodity Markets Oversight Coalition (CMOC) from 2009 to 2013, and the Derivatives Task Force of Americans for Financial Reform since 2010. IATP has submitted comments on U.S. Commodity Futures Trading Commission rulemakings, and on consultation papers of the International Organization of Securities Commissions, Financial Stability Board, the European Securities and Markets Authority, and the European Commission's Directorate General for Internal Markets (now Directorate General for Financial Markets).

[3] https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2984 and Suppan, "Data gaps and market disruptions," Institute for Agriculture and Trade Policy, November 7, 2019. https://www.iatp.org/blog/202002/data-gaps-and-market-disruptions

[4] "Graph 4. Four Banks Dominate in Derivatives," "Quarterly Report on Bank Trading and Derivatives Activities: Third Quarter 2019," Office of the Comptroller of Currency, https://www.occ.treas.gov/publications-and-resources/publications/quarterly-report-on-bank-trading-and-derivatives-activities/files/q3-2019-derivatives-quarterly.html

[5] Adam Hayes, Herfindahl-Hirschman Index (HHI), Investopedia, February 11, 2020. https://www.investopedia.com/terms/h/hhi.asp

[6] Jim Tankersley, "Trump Administration Sees No Threat to Economy from Monopolies," *The New York Times*, February 20, 2020. https://www.nytimes.com/2020/02/20/business/trump-economy-monopoly.html?action=click&module=Latest&pgtype=Homepage

[7] https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61057&SearchText=Institute%20for%20Agriculture%20and%20Trade%20Policy at 5.

[8] "OTC Derivatives Market Reforms: Progress Report on Implementation," Financial Stability Board, October 15, 2019. https://www.fsb.org/wp-content/uploads/P151019.pdf

[9] https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1752 at 10.

[10] http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-52

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[13] Andrew Park, "Those $700 billion in US CLOs: Who holds them, what risk they pose," S&P Market Intelligence, June 13, 2019. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/leveraged-loan-news/those-700b-in-us-clos-who-holds-them-what-risk-they-pose

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[15] E.g. "The scale of misconduct in some financial institutions has risen to a level that has the potential to create systemic risks. Fundamentally, it threatens to undermine trust in financial institutions and markets, thereby limiting some of the hard-won benefits of the initial reforms." Financial Stability Board Chairman Mark Carney, in a February 4, 2015 letter to G20 Finance Ministers and Central Governors. http://www.fsb.org/wp-content/uploads/FSB-Chair-letter-to-G20-February-2015.pdf and David Segal, "It May Be the Biggest Tax Heist Ever. And Europe Wants Justice," *The New York Times*, January 24, 2020. https://www.nytimes.com/2020/01/23/business/cum-ex.html

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[17] Ibid., 17 et passim.

[18] "OTC Derivatives Market Reforms: Progress Report on Implementation," 5-7.

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[21] James Andrew Felkerson, "$29,000,000,000,000: A Detailed Looks at the Fed's Bailout by Funding Facility and Recipient," Levy Economics Institute, Working Paper No. 698, December 2011. http://www.levyinstitute.org/publications/29000000000000-a-detailed-look-at-the-feds-bailout-by-funding-facility-and-recipient

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[28] https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/DoddFrankCDF5.html

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